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SUBJECT: SCENESETTER: VISIT OF CODEL GRAMM TO THE
NETHERLANDS: THE DUTCH ECONOMY AND EMU

REF: SECSTATE 104182

1. Summary: With a booming economy, ample budget surpluses, and a rapidly declining national debt, the Netherlands is exceptionally well positioned for the coming of the euro. So far, businessmen believe that the benefits of the transition have far exceeded the costs, but the Dutch Central Bank has urged the business community not to fall behind in their preparations for the 2002 transition. Substantial U.S. corporate investment here, and accelerating Dutch acquisitions in the U.S., underscore the continuing importance of the U.S. link for the Dutch economy. U.S. regulatory issues, particularly in the financial services sector, remain a major interest for many Dutch corporations. End Summary.

THE DUTCH ECONOMY: LEADING EUROPE

2. After near disaster in the early 1980s, major players in the Dutch economy, business and union leaders forged a historic consensus linking long-term wage restraint to increased investment. This consensus is generally referred to as the "polder model" after the artificially-drained fields characteristic of the Dutch landscape, and later allied to increasing fiscal conservatism. It has yielded impressive results. The Dutch now enjoy an economic growth rate of more than 3 percent, an unemployment rate under 4 percent (with 200,000 job vacancies), and a second consecutive year of budget surplus. National debt has declined from 67 percent to 58 percent in the past two years, leaving the Dutch well within the conditions for joining European economic and monetary union. All in all, the economy is perhaps the soundest in Europe. The labor market, while in some respects more rigid than in the U.S., is among the most flexible in Europe. Burgeoning temporary-help agencies -- the latest labor-market trend -- offer employers additional flexibility.

3. There are some clouds on the horizon, however. For example, the low unemployment rate does not take account of persistent long-term unemployment among certain groups, especially those over 55, the less educated, and immigrants with limited language skills. Labor participation is also relatively low among married women. Moreover, years of government effort have failed to reduce substantially the unusually large proportion of the workforce out on disability payments -- a total of 930,000 people out of a labor force of about 7 million. Although the Dutch pension system is currently financially sound, an aging population, combined with the Dutch penchant for retiring early, points to the need to raise participation in the labor market.

4. The government has taken a number of measures to address these issues. Among other things, it has budgeted more money for day care, and reformed the tax system to reduce disincentives to work. It is also attempting to combat age discrimination among employers.

TRADE AND INVESTMENT PATTERNS

5. The Netherlands is a quintessentially open, service-oriented economy, with trade accounting for over 80 percent of its GDP. The US had a trade surplus with the Netherlands in 1999 of USD 11 billion on close to USD 30 billion of total trade, reflecting the importance of the Netherlands as a distribution base for US products in Europe. The U.S. is one of the largest investors in the Netherlands with a total of over USD 80 billion in existing investment.

16. The Netherlands has long been one of the top three investors in the U.S.; while statistical lags make it impossible to say for certain, we believe that the rapid rate of Dutch investment in 1999 and 2000 has pushed them into the top slot. In the year 2000 alone, widely reported Dutch acquisitions in varied sectors including financial services and food products have totaled USD 79 billion. U.S. acquisitions in the Netherlands have attracted less attention and are difficult to quantify, but US foreign direct investment in the Netherlands continues apace. Most recently Cisco Systems announced a large long-term direct investment near Amsterdam. US investors generally cite the quality of the Dutch workforce, efficient infrastructure, a favorable and predictable tax system and general regulatory structure, and the unbeatable location of the Netherlands as a transit hub as reasons to locate here.

EFFECTS OF EMU ON THE DUTCH ECONOMY

17. As strong supporters of the EU, the Dutch also naturally backed EMU. As a practical matter, the Netherlands linked its currency, the guilder, to the Deutschmark in 1990, thus effectively giving up independent monetary policy as an economic tool. The potential loss of sovereignty involved in EMU was therefore less troubling to the Dutch than to larger member states. Due to careful fiscal management in the 1990s, the Dutch also had little to do to meet the so-called "EMU criteria" regarding budget deficits and debt as percentage of GDP.

18. However, the move forward in 1997 to the second stage of EMU caused some trepidation among Dutch policymakers, and aroused little enthusiasm among the general public. Among other things, some politicians (including Finance Minister Zalm) were uneasy about the inclusion of macroeconomically marginal candidates such as Italy, and about French attempts to establish some measure of political control over the decision of the European Central Bank. French efforts to displace Dutchman Wim Duisenberg as first European Central Bank (ECB) President did nothing to allay these concerns. In the end, however, the political establishment suppressed any qualms and held firmly to its commitment to EMU.

19. In general, the business community expects EMU to be a net benefit to the Netherlands. Early studies estimated that the costs of preparing for EMU would be more than offset by the benefits, ranging from lower exchange costs to competitive gains. The Dutch are confident of their own competitiveness and expect EMU to offer them increased market opportunities by lowering remaining barriers to neighboring markets and increasing price transparency.

110. Dutch banks are also looking to EMU with optimism. Two of the three major Dutch banks are among the top twenty in Europe; ABN-AMRO is hoping to develop a niche market as a clearing bank throughout Europe as well as jumping into the Internet banking market. In the long term, Central Bank studies have also predicted that EMU would spur disintermediation in European financial markets and a shift from debt to equity financing that could help lower capital costs, especially for healthy Dutch firms.

STAGE THREE: ARE THE DUTCH READY FOR THE EURO?

111. The third stage of EMU -- the irrevocable fixing of exchange rates and introduction of the Euro in financial markets -- took place in January 1999. While the Dutch have had no difficulty meeting the basic criteria for EMU, and have enjoyed relatively low inflation under European Central Bank monetary policies, Dutch efforts to prepare for actual introduction of the currency appear to be lagging behind.

112. The latest survey by the Dutch Central Bank

(DNB) estimates that the Dutch business community can expect about USD 3.5 billion in increased revenues as a result of the introduction of the euro. The survey also predicts that the euro will bring around USD 2.5 billion in new investments into the Netherlands. Despite these attractive prospects, many Dutch businesses have been slow to begin accepting euro payments.

¶13. Fewer than 1 percent of Dutch companies do business, or pay taxes, in euros. 80 percent of large businesses have a plan for switching over to the euro, but many smaller firms have not yet focused on the issue. The Central Bank has warned that companies without a plan for euro conversion risk missing the deadline.

¶14. The banks began the necessary software revision for transition to the Euro over a year ago, but some of these preparations were retarded by the need to troubleshoot for Y2k, which led to an acute shortage of technical personnel. Moreover, while the banks have begun to issue bank statements in guilders and euros, and to offer business-to-business transactions in euro, they have been reluctant to encourage consumers to open euro accounts or pay bills in euro.

¶15. Nevertheless, the Central Bank survey concluded that an overall majority of households and businesses have faith in the euro. However, although most Dutch people and companies feel fully informed about the euro, attempts to increase euro knowledge in the last year through intense media campaigns seem to have failed.

¶16. Dutch Trade Minister Gerrit Ybema has argued that EMU will benefit both Europe and the US. Europe will see increased price stability and transparency, and experience fewer deadweight losses from currency conversion costs. Ybema predicted that US companies will benefit from the stabilization of prices and exchange rates as much as their European counterparts. He also suggested that EMU will increase the demand for imported goods throughout the EU, as well as decrease the costs of EU imports headed for the United States.

¶17. We believe that US companies in the Netherlands will be among the prime beneficiaries of EMU. As most US companies based here operate Europe-wide, elimination of exchange costs will be a substantial saving. The introduction of the euro in consumer transactions will probably further accelerate development of e-commerce in Europe.

THE ROLE OF MINISTER ZALM

¶18. Finance Minister Gerrit Zalm, whom you will meet on your visit here, is in his seventh year as Minister and has been a key figure in the shaping of Dutch fiscal policy and the Dutch approach to EMU. In his first five years as finance minister, he was responsible for holding the government on a fiscally conservative course. Under his leadership the government also rationalized its previously ad hoc and chaotic budget process. As finance minister, he has also taken a tough line both on the budget and on European issues, negotiating a substantial reduction in the net Dutch contribution to the EU budget.

¶19. In the current coalition government, which began in August 1998, Zalm's ability to maintain fiscal discipline was vastly aided by windfall revenue gains that pushed the budget into surplus. While government spending will increase, portions of the windfall have been used to pay down the national debt, with the result that debt service payments have declined substantially.

¶20. Zalm has also led an effort to overhaul the Dutch tax system in order to lower marginal tax rates (still higher than those in the U.S.), eliminate loopholes, remove tax disincentives for two-income couples, and to eliminate the "poverty trap" created by the fact that total benefits and

subsidies granted to the unemployed often exceed net income at the minimum wage.

21. Zalm was among the Dutch politicians calling for care in the selection of entrants to EMU. Along with the leader of his party, the right-of-center VVD, he was accused of "spaghettiphobia" for voicing his doubts about the inclusion of Italy, Spain and Portugal in the initial eleven EMU entrants. Nevertheless, Zalm has publicly proclaimed himself satisfied with the transition so far; as he noted, getting eleven European countries to vote on a single coin design is in itself a signal success. He has also said, as have other observers, that EMU proved itself by maintaining European economic momentum during the Asia crisis.

22. Bio notes: Although he is the senior VVD minister, Zalm is not a career politician. Zalm was born in the historic Zuider Zee port of Enkhuizen on May 6, 1952, and was educated at the Free University of Amsterdam, where he received a doctorate in economics and was generally regarded as a brilliant student. He immediately began a career in public policy in the budget division of the Ministry of Finance, then moved to the Ministry of Economics where he became director of general economic affairs. He visited the U.S. on a USIS grant in 1986. In 1988, he joined the Central Planning Bureau, the independent government planning and forecast agency, and became director a year later. He was appointed finance minister in August 1994 at the start of the first Kok cabinet.

US BANKS IN THE NETHERLANDS

23. US banks are well-established in the Netherlands, but concentrate on serving their global customers and exploiting niche markets rather than retail banking. Most observers believe that the large Dutch retail banks will continue to dominate their own domestic market even with EMU. However, we have heard no complaints about market barriers or "doing-business" issues from the U.S. banking community.

DUTCH BANKS AND INSURERS IN THE UNITED STATES

24. Dutch investment in the U.S. financial services sectors totalled USD 21 billion in 1998, the last year for which we have statistics; taking account of the 1999 takeover of Transamerica by Dutch firm Aegon, (USD 19 billion) the total is probably considerably higher this year. The two biggest Dutch banks are big players in U.S. financial services sectors: ABN-AMRO has over USD 100 billion in holdings and 18,000 employees in the U.S., including Lasalle Group and Standard Federal Bancorporation in the Midwest, while ING has over USD 30 billion in US insurance activities.

25. Dutch banks, especially ING, welcomed the easing of Glass-Steagall restrictions. Current concerns include the role of US regulatory authorities in the debate over restitution of assets confiscated from Holocaust victims. Aegon, which cooperates with the Dutch Jewish Community in finding and paying insurance-related claims, appears to have resolved the issue with U.S. insurance commissioners and the Eagleburger Committee. The banks and the Amsterdam Stock Exchange have just reached a settlement worth about USD 150 million with the Dutch Jewish Council and the World Jewish Congress.

SCHNEIDER